

# CFTC Rules 4.5 and 4.13 – Issues Impacting Registered Investment Companies and Private Funds

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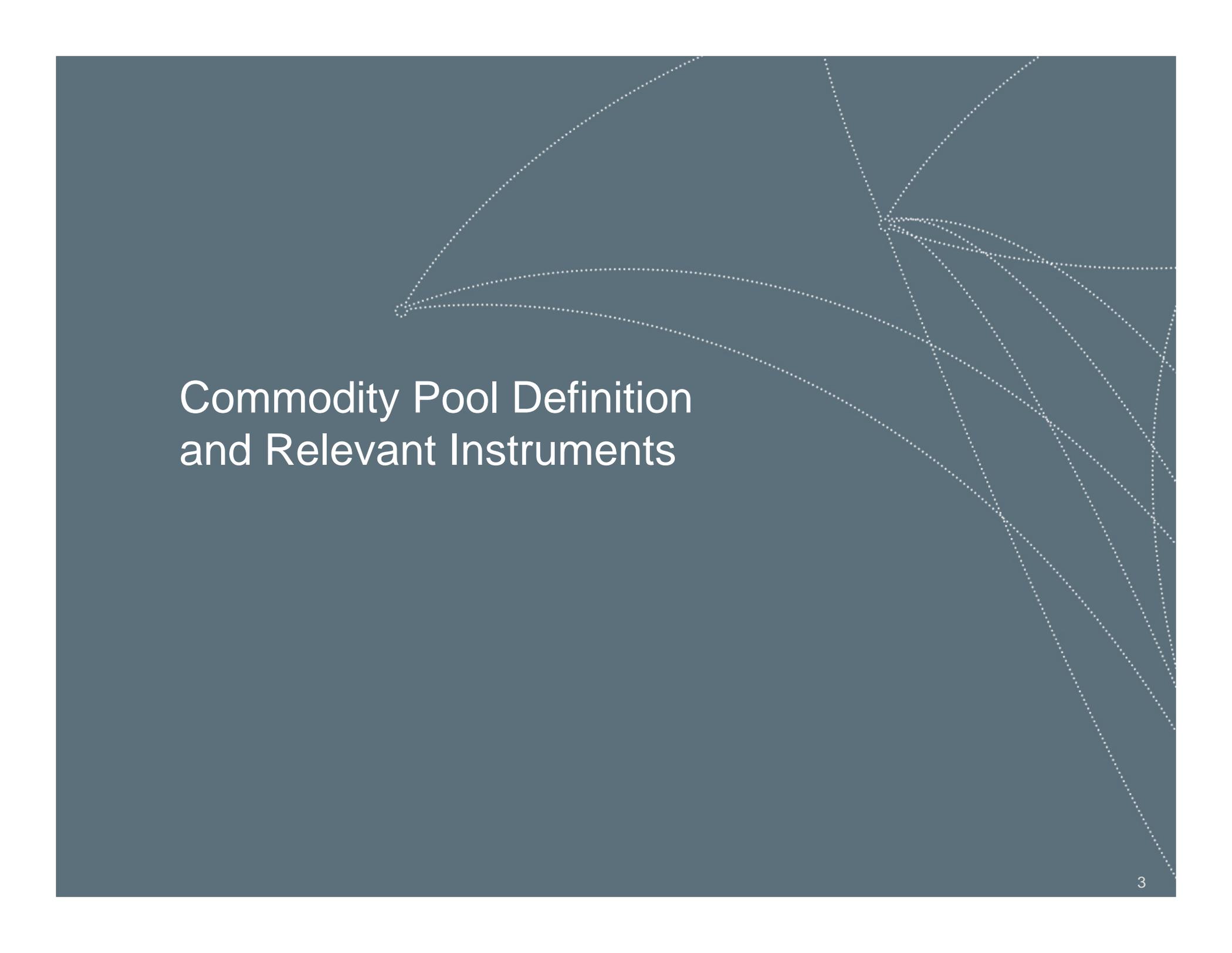
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## Introduction

CFTC Rule Amendments, February 2012:

- Amends Rule 4.5 – Affecting Registered Funds
- Rescinds Rule 4.13(a)(4) – Affecting Private Funds
- Omits Appendix A Fund-of-Funds Guidance
- Adopts New Forms CPO-PQR and CTA-PR



# Commodity Pool Definition and Relevant Instruments

## Commodity Pool Definition

- Commodity Pool: Defined in Commodity Exchange Act (“CEA”) Section 1(a)(10): an investment trust, syndicate, or similar enterprise that invests in the following “commodity interests”:
  - futures contracts (including “security futures”)
  - options on futures
  - swaps (excluding “security-based swaps”)
  - “retail forex”
- Inclusion of “swaps” is not effective until the “Swap Effective Date”: the earlier of July 16, 2012 or the effective date of the regulations adopted by the CFTC and the SEC further defining the term “swap”
  - “Swap” is defined in CEA Section 1a(47) and generally includes any agreement, contract or transaction based upon an exchange of payments tied to a notional amount of an asset, index, or rate
- A fund falls into the commodity pool definition even if it invests in commodity interests indirectly through another fund

## Instruments That Do Cause a Fund to Fall within the Commodity Pool Definition

### FUTURES / OPTIONS ON FUTURES

- All futures, including “security futures” -- futures based on either a single security or a “narrow-based securities index” (9 or fewer components and certain required weightings)

### SWAPS (including swaptions)

- Swaps on commodities, interest rates, currencies, securities, etc.
- Includes swaps on broad-based securities indices, government securities, and municipal securities
- Excludes “security-based swaps”
- Does not apply to “FX swaps” and “FX forwards”, if exempted by Treasury – generally physically settled with exchange of currencies

### MIXED SWAP

- A swap based on one or more components of a security-based swap and one or more components that are not within the security-based swap definition

## **Instruments That Do Not Cause a Fund to Fall within the Commodity Pool Definition**

### **SECURITIES / OPTIONS ON SECURITIES**

#### **SECURITY-BASED SWAPS (including security-based swaptions)**

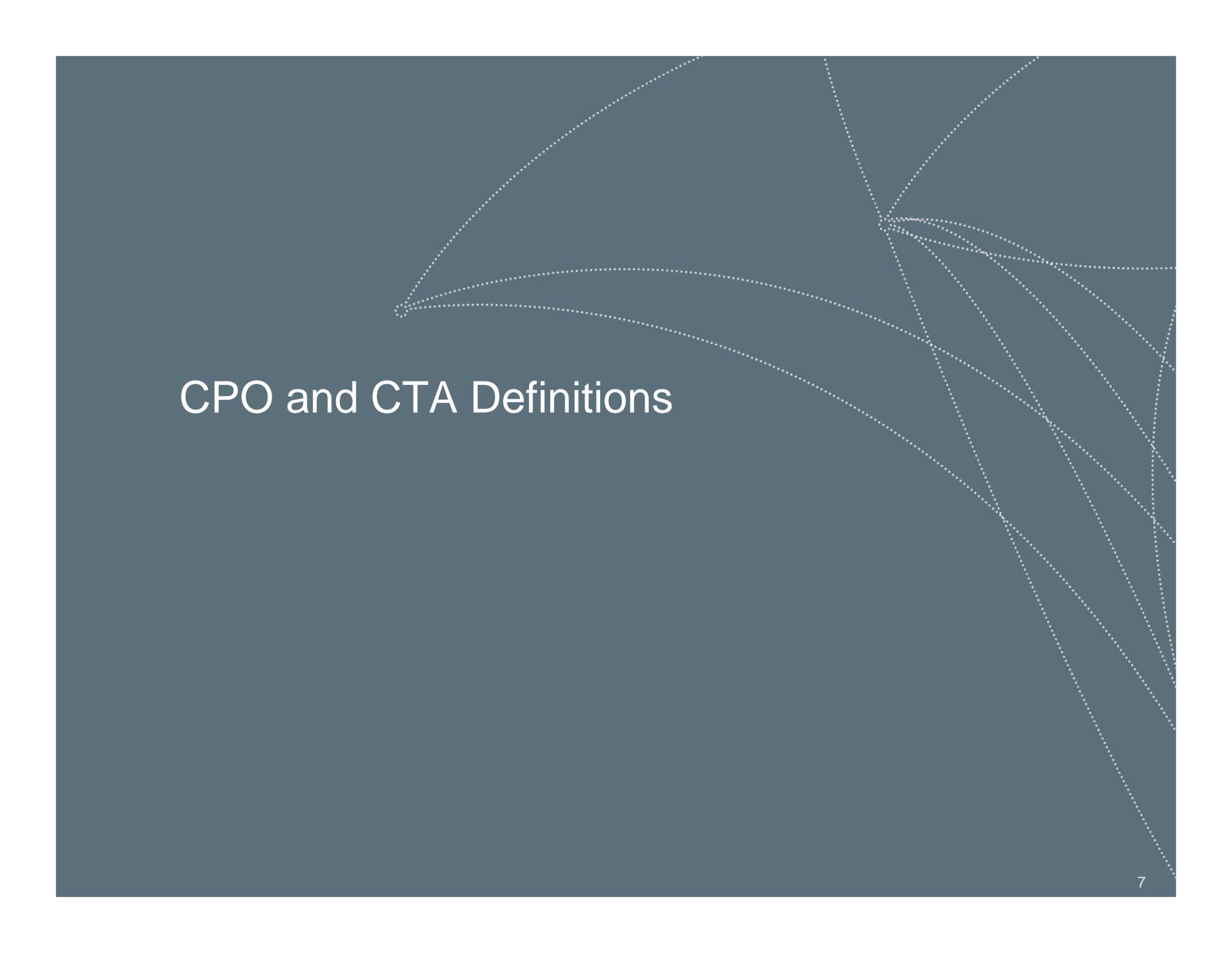
- Swaps based on single security or single loan (Ex: single-name CDS)
- Swaps based on a “narrow-based security index” (9 or fewer components and certain required weightings)
- Swaps based on a self-developed broad-based security index where component securities may be changed by one of the parties (proposed)

#### **PHYSICALLY-SETTLED FORWARDS**

- Requires the intention of physical settlement
- On commodities and on securities

#### **PHYSICALLY-SETTLED “FX SWAPS” AND “FX FORWARDS” (PROPOSED)**

- Among other characteristics, requires the actual exchange of the two currencies



# CPO and CTA Definitions

## Definition of CPO

- CPO is someone who operates a commodity pool and who solicits assets from investors for the purpose of trading commodity interests
  - CFTC reads the definition broadly to include any person “that handles or exercises control over” the commodity pool assets, regardless of whether or not they engage in solicitation
  - CFTC also looks at the person who has the authority to hire and fire the pool’s CTA and select and change the pool’s FCM
  - CPO of registered fund is the adviser (Rule 4.5 Adopting Release)
  - CPO of a controlled foreign corporation (“CFC”) may be the adviser to the CFC (informal staff views)
  - CPO of multi-manager fund is the adviser
  - CPO of unregistered fund generally is the GP or Managing Member, but could be the adviser
  
- Swaps are not effectively included in the CPO definition until the Swap Effective Date

## Definition of CTA

- CTA is someone who provides trading advice with respect to commodity interests
  - The investment adviser to a registered fund is usually both the CPO and the CTA
  - A sub-adviser to a fund generally is a CTA but not a CPO
  - A sub-adviser that does not provide commodity trading advice to a fund is not a CTA
  - The investment adviser to an unregistered fund is usually the CTA (but could also be the CPO)
  - In a separate account, the investment adviser is a CTA; there is no CPO
- Swaps are not effectively included in the CTA definition until the Swap Effective Date

## Multi-Managed Funds and Funds-of-Funds

- *Who has to register as the CPO of a multi-manager fund: just the investment adviser or both the adviser and the subadviser(s)? To the extent registration is required, who has to register as a CTA?*
  - The investment adviser would be the CPO
  - CTA defined very generally to include any person who provides advice about trading in commodity interests for compensation or profit, and includes persons who make commodity interest trading decisions on behalf of pools
  
- *For Funds that invest in underlying funds that hold commodity interests, may those Funds rely on the guidance in Appendix A to Rule 4.13(a)(3) in determining whether their operators must register as CPOs?*
  - A member of the CFTC staff has said that a new version of the Appendix will be republished and will cover Rules 4.5 and 4.13(a)(3)
  - A member of the CFTC staff has stated that firms may rely on the existing version of Appendix A until the new version is adopted



# Rules 4.5 and 4.13(a)(3)

## CPO Exclusion – Rule 4.5 (as amended)

- Rule 4.5 excludes from the definition of CPO “qualifying entities” that operate pools that are regulated by some other regulatory authority
- A qualifying entity is:
  - a registered investment company that complies with certain trading limitations and marketing restrictions;
  - an insurance company with respect to the operation of a separate account;
  - a bank, trust company or any financial depository institution with respect to the assets of a trust, custodial or other separate unit of investment for which it is acting as a fiduciary and for which it is vested with investment discretion; or
  - a trustee of, named fiduciary of, or an employer maintaining, a pension plan that is subject to ERISA Title I, and certain plans are not even considered pools (including Title I non-contributory plans, Title IV contributory plans, government plans, employee welfare plans, and church plans)

## CPO Exclusion – Rule 4.5 (as amended)

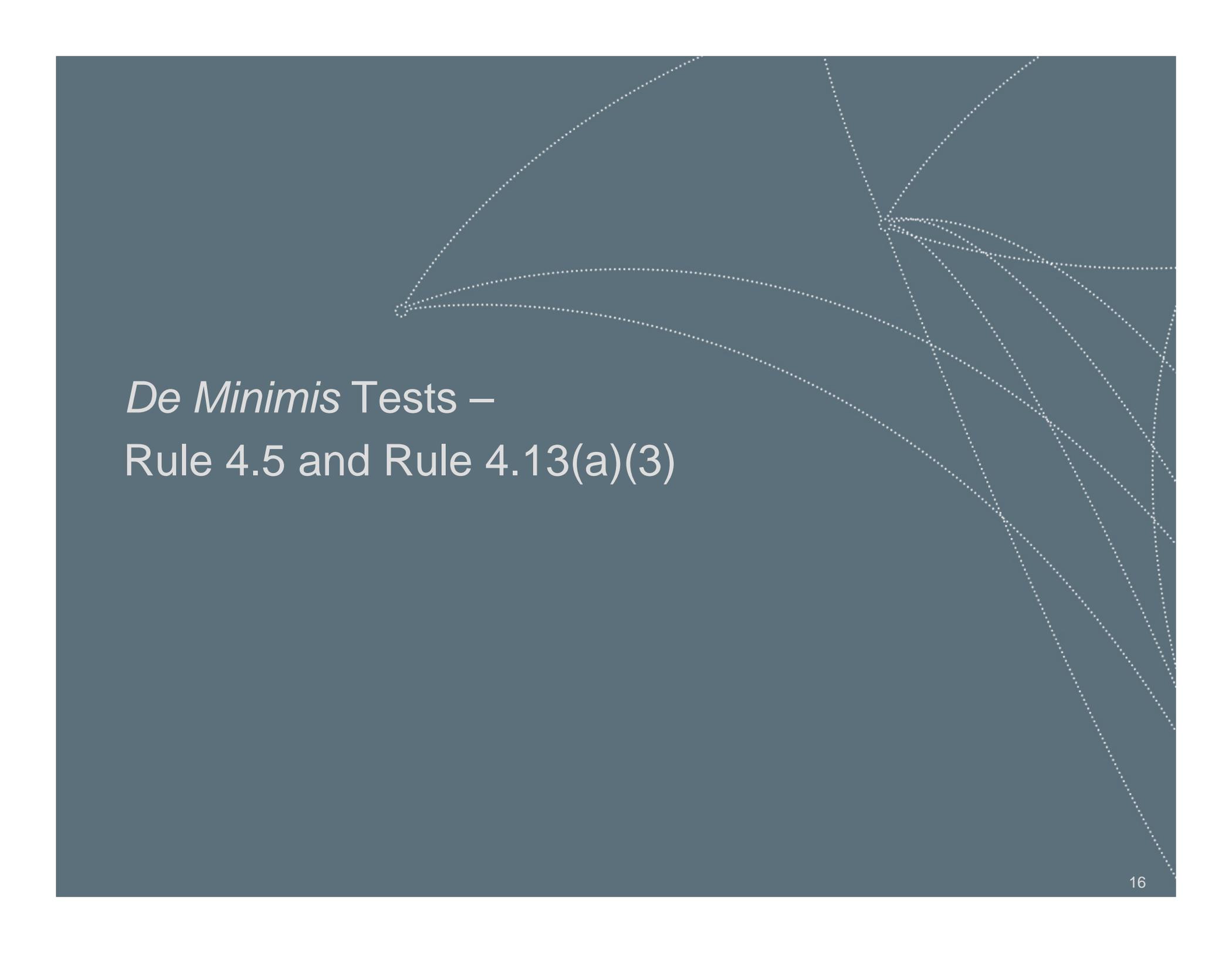
- On February 8, 2012, the CFTC adopted an amendment to CFTC Rule 4.5 as it applies to registered investment companies, and requires registered funds relying on the rule to:
  - refrain from marketing itself as a vehicle for trading in the commodity futures, commodity options or swaps markets; and
  - other than bona fide hedging transactions (which are not limited), comply with *de minimis* restrictions:
    - limit the aggregate initial margin and premiums required to establish such positions to no more than 5% of the liquidation value of the pool's portfolio after taking into account unrealized profits and losses; or
    - ensure that the aggregate net notional value of such positions does not exceed 100% of the liquidation value of the pool's portfolio after taking into account unrealized profits and losses

## CPO Exemption – Rule 4.13(a)(3)

- Rule 4.13(a)(3) requires that pool investors either be non-U.S. persons or meet a standard basically equivalent to an “accredited investor” standard and that the pool trade only a *de minimis* amount of commodity interests whether entered into for *bona fide* hedging purposes or otherwise
- Specifically:
  - the aggregate initial margin, premiums, and required minimum security deposit for retail forex transactions required to establish such positions cannot be more than 5% of the liquidation value of the pool’s portfolio after taking into account unrealized profits and losses; or
  - the aggregate net notional value of such positions does not exceed 100% of the liquidation value of the pool’s portfolio after taking into account unrealized profits and losses

## **Rescission of Rule 4.13(a)(4) – Exemption for Pools with Highly Sophisticated Investors**

- On February 8, 2012, the CFTC rescinded Rule 4.13(a)(4) (effective April 24, 2012), which contained a broad exemption from most of the CPO requirements
- Rule 4.13(a)(4) generally required investors to meet the “qualified purchaser standard” or be non-United States persons
- Rule 4.13(a)(4) did not contain any limit on the amount of a pool’s trading in commodity interests
- As a result of the rescission of Rule 4.13(a)(4), private fund managers will have to either comply with Rule 4.13(a)(3), or register as a CPO
- Rule 4.7 (CPO-Lite) likely will return to prominence



*De Minimis* Tests –  
Rule 4.5 and Rule 4.13(a)(3)

## 5% Test

The aggregate initial margin, premiums, and required minimum security deposit for retail forex transactions required to establish such positions, determined at the time the most recent position was established, will not exceed 5 percent of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into.

- This test is measured whenever a new position is established
- Liquidation value is net asset value
- The calculation includes initial margin/premium only; does not include variation margin
- Exclude “swaps” until Swap Effective Date
- There is no safe harbor for occasional failures to meet the test

## 100% Notional Test

The aggregate net notional value of commodity futures, commodity options contracts, or swaps positions, determined at the time the most recent position was established, does not exceed 100 percent of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into.

- This test is measured whenever a new position is established
- Liquidation value is net asset value
- Exclude “swaps” until Swap Effective Date
- Useful alternative to the 5% Test because margin levels for broad-based stock index futures and security futures tend to exceed levels for other commodity interests, which may make it difficult to satisfy the 5% Test
- There is no safe harbor for occasional failures to meet the test

## 100% Notional Test *(cont'd)*

- Notional value determined by asset class:
  - For futures contracts, multiply the number of contracts by the size of the contract, in contract units (taking into account the multiplier in the contract), by the current market price per unit
  - For options, multiply the number of contracts by the size of the contract, adjusted by the delta, in contract units (taking into account the multiplier specified in the contract), by the strike price per unit
  - For cleared swaps, by the value as determined consistent with CFTC's Part 45 regulations (this is unclear, but possible meaning is the notional value of the contract)
  - Notional value is not defined for uncleared swaps (possible meaning is the notional value of the contract)
- Netting determined by asset class:
  - For futures contracts, net across designated contract markets or foreign boards of trade
  - Options not addressed
  - For cleared swaps, net if cleared by the same derivatives clearing organization "where appropriate"
  - Not permitted for uncleared swaps

## Funds-of-Funds – *De Minimis* Test

- Appendix A to Part 4 Rules -Guidance on the Application of Rule 4.13(a)(3) in the Fund-of-Funds Context – provided 6 examples:
  - Examples include:
    - FOF that invests in unaffiliated fund with a registered CPO
    - FOF that invests in unaffiliated fund itself relying on Rule 4.13(a)(3)
    - FOF that invests in affiliated fund
- Appendix omitted from final rule adoption



## Rule 4.5 – *Bona Fide* Hedging

## ***Bona Fide Hedging***

- Defined in Rule 1.3(z)(1) for Non-Physical Commodities as positions that:
  - Normally (but not necessarily) represent a substitute for positions to be taken at a later time in the physical marketing channel
  - are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise
  - arise from the potential change in the value of the fund's current or anticipated assets or liabilities, or
  - are for the purpose of offsetting price risks incidental to commercial cash or spot operations
- Rule 1.3(z)(1) applies to uncleared swaps as well as exchange-traded transaction.
- Defined in Rule 151.5 for Physical Commodities – in most ways, similar to above definition

## ***Bona Fide* Hedging – Rule 1.3(z)(1) – Risk Reducing v. Risk Management**

- In the Feb. 2012 Rule 4.5 adopting release, the CFTC declined to expand *bona fide* hedging to include risk management, noting:
  - risk management transactions likely present more market risk because they are not offset by exposure in the physical markets
  - risk management transactions include transactions to equitize cash, if such transactions are not within the definition of *bona fide* hedging
    - “anticipatory hedging” should remain within definition of *bona fide* hedging
- A September 1987 CFTC release distinguishes between risk management transactions and risk reduction strategies that would qualify as *bona fide* hedging:
  - Example: a fund manager wants to temporarily increase exposure to equities relative to debt but, instead of purchasing more equity securities or selling some Treasury securities, enters into long broad-based stock index futures and shorts Treasury bond or note futures
  - Short Treasury bond or note futures would be a *bona fide* hedge against previously purchased Treasury securities
  - Long stock index futures would not be a hedge of the existing equity securities in the portfolio, because in effect the fund would be “long” equities and “long” a stock index future  
(52 Fed. Reg. 34633, 34635 (September 14, 1987))



## Rule 4.5 – Marketing Restriction

## Marketing Restriction

- Amended Rule 4.5 prohibits a fund whose adviser has not registered as a CPO from marketing the fund as a commodity pool or as a fund for trading in commodity interests
- CFTC provided a list of factors, with no single factor being conclusive, that would be considered on a case-by-case basis when evaluating whether a fund satisfies the Marketing Restriction
- Note: A fund can pass the bona fide hedging and de minimis tests and still fail the Marketing Restriction
  - Ex. A FOF can pass the hedging and de minimis tests by investing in underlying funds with registered CPOs, but if such investments merit significant disclosure in the prospectus or SAI, the fund may fail the marketing test

## Marketing Restriction – Factors

- Fund name
  - The CFTC clarified that a fund name that includes the terms “futures” or “derivatives,” or otherwise indicates a possible focus on futures or derivatives, will not be a dispositive factor, but rather one of many that should be considered in making the determination
- Primary investment objective tied to a commodity index
- Use of a CFC for derivatives trading
  - The CFTC stated that a Fund’s use of a CFC may indicate that such Fund is engaging in derivatives trading in excess of the trading threshold

## Marketing Restriction – Factors *(cont'd)*

- References in a prospectus or other disclosure document to the benefits of using derivatives or comparisons to a derivatives index
  - The CFTC clarified, however, that it will not consider the mere disclosure to investors or potential investors that the fund may engage in derivatives trading incidental to its main investment strategy and the risks associated therewith as being violative of the Marketing Restriction
- Net short speculative exposure to any commodity through a direct or indirect investment in other derivatives in the course of normal trading activities
- Commodity interests as a primary source of potential gains and losses
- Explicitly offering a managed futures strategy
  - The CFTC will give this factor more weight in determining whether a fund is a *de facto* commodity pool
  - The CFTC stated that, if a fund offers a strategy with several indicia of a managed futures strategy, but avoids explicitly describing the strategy as such in its offering materials, that fund could still be found to have violated the Marketing Restriction based on these other factors



# Notice Requirements and Effective/Compliance Dates

## Notice Filings

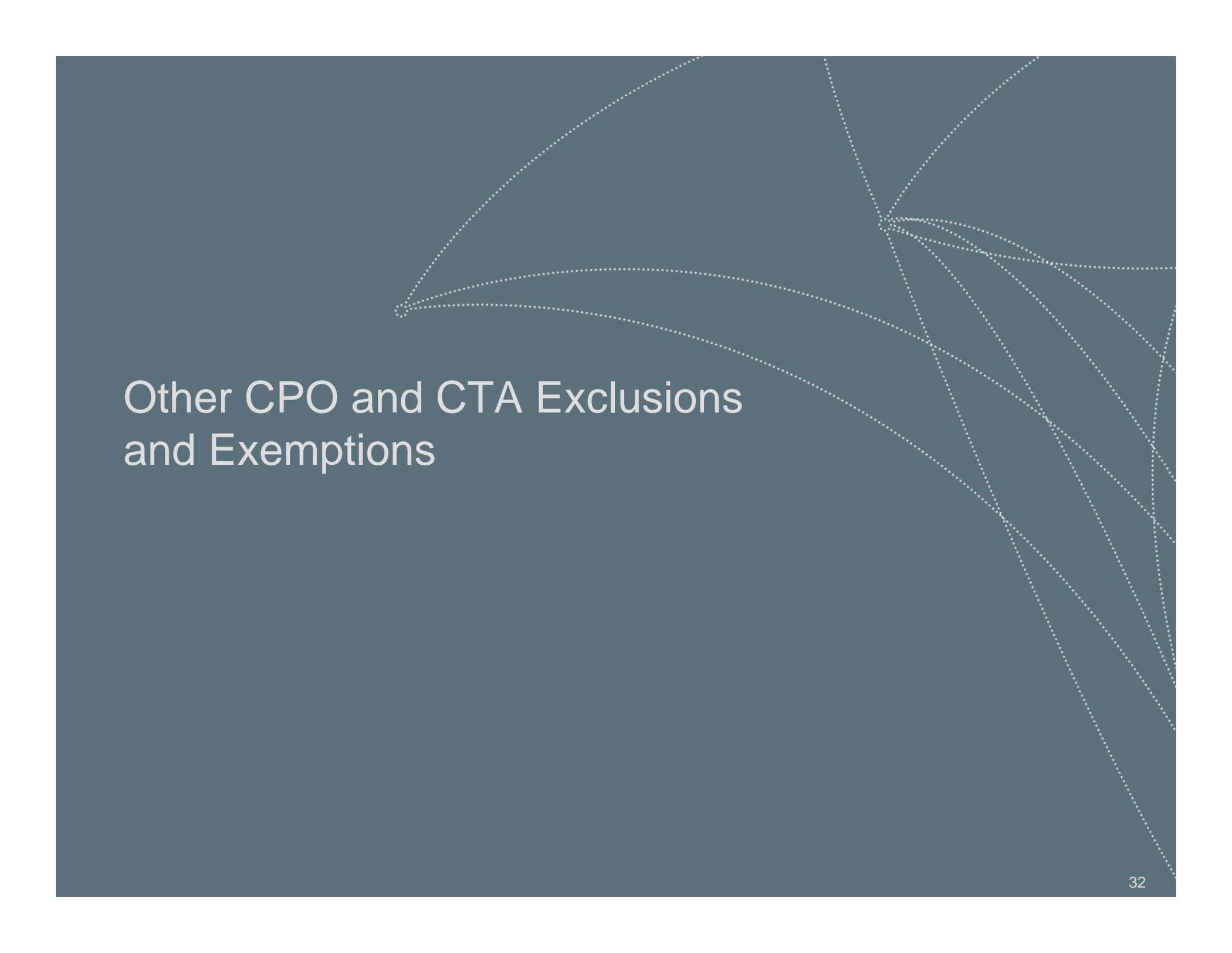
- Pre-amendment versions of Rule 4.5 and Rule 4.13 require operators of funds claiming relief from CPO registration to electronically file with NFA a notice claiming such exclusion once
- Amended rules require annual notices. The CPO must re-affirm its eligibility to rely on the exclusion/exemption within 60 days of the end of each calendar year, withdraw the notice if it ceases to conduct activities requiring registration or exclusion from registration, or withdraw the notice and apply for registration

## Effective and Compliance Dates

- April 24, 2012 is the general effective date for amendments to Rule 4.5, Rule 4.7, and Rule 4.13
- Rule 4.5:
  - For a registered fund with a Rule 4.5 notice on file prior to April 24th (and for a CFC with a Rule 4.13(a)(4) notice on file prior to April 24th), registration is not required until the later of:
    - December 31, 2012 or
    - 60 days after publication of final regulations defining “swap” and establishing swap margin requirements
  - For a registered fund that does not have a Rule 4.5 notice on file prior to April 24<sup>th</sup>, CPO must immediately comply with amended Rule 4.5 or register as a CPO
  - For a CFC that does not have a Rule 4.13(a)(4) notice on file prior to April 24<sup>th</sup>, CPO must immediately register as a CPO and Rule 4.7 may be unavailable
  - For a registered fund, recordkeeping, reporting, and disclosure requirements are not effective until 60 days after publication of final regulations “harmonizing” SEC and CFTC regulations
  - CPOs do not count “swaps” for purposes of compliance with Rule 4.5 until final swap definition regulations are effective

## Effective and Compliance Dates *(cont'd)*

- Rule 4.13:
  - For a private fund with a Rule 4.13(a)(4) notice on file prior to April 24<sup>th</sup>, registration is not required until the later of:
    - December 31, 2012 or
    - 60 days after publication of final regulations defining “swap” and establishing swap margin requirements
  - For a private fund that does not have a Rule 4.13(a)(4) notice on file prior to April 24<sup>th</sup>, CPO must immediately comply with Rule 4.13(a)(3) or register as a CPO (Rule 4.12(b) or Rule 4.7 may be available)
  - CPOs do not count “swaps” for purposes of compliance with Rule 4.13(a)(3) until final swap definition regulations are effective



# Other CPO and CTA Exclusions and Exemptions

## CPO Exemption – Rule 4.7 (CPO-Lite)

- For registered CPOs only: CFTC Rule 4.7(b) provides an exemption from almost all the disclosure, reporting, and recordkeeping requirements otherwise applicable to registered CPOs
- The fund must be composed solely of persons that the CPO “reasonably believes” are “qualified eligible persons” (“QEPs”)
- Furthermore, the pool must be sold in an offering exempt from the registration requirements of the Securities Act pursuant to Section 4(2) (for example, under Rule 506 of Rule D) or Rule S, or by a bank registered as a CPO with respect to a collective trust fund exempt from registration under Section 3(a)(2) of the Securities Act
- These pools may not be marketed to the public
- Notice requirements

## CPO Exemption – Rule 4.7 (CPO-Lite) *(cont'd)*

- QEP definition (CFTC Rule 4.7(a)(2) and (a)(3))
  - Includes “qualified purchasers,” “knowledgeable employees,” and non-U.S. persons, (same eligibility requirements for 1940 Act Section 3(c)(7) funds)
  - Other persons who must meet an additional “Portfolio Requirement”
    - Includes natural person “accredited investors,” provided they meet the Portfolio Requirement: they must own \$2 million in investments, have on deposit with a futures commission merchant (“FCM”) at least \$200,000 in initial margin and option premiums, or a combination of both

## CPO Exemption – CFTC Rule 4.12(b) (CPO-Medium)

- For registered CPOs only: CFTC Rule 4.12(b) is available, provided:
  - The pool is offered and sold in compliance with the registration requirements of the Securities Act, or an exemption from such registration requirements;
  - The CPO is engaged generally and routinely in the buying and selling of securities and securities-derived instruments;
  - The CPO trades commodity interests in a manner “solely incidental” to its securities trading activities; and
  - The CPO does not enter into commodity interest transactions for which the aggregate initial margin and premiums, and required minimum security deposit for retail forex transactions, exceed 10% of the fair market value of the pool’s assets, after taking into account unrealized profits and unrealized losses on such contracts. In the case of an option that is in-the-money at the time of purchase, the in-the-money amount (as defined in CFTC Rule 190.01(x)) may be excluded in computing such 10%.
- Exempts the CPO from only some of the disclosure (primarily, disclosure of past performance of the pool and its principals, and the pool’s CTA and its principals), reporting, and recordkeeping requirements generally applicable to CPOs
- Note: This is not useful for registered funds given other needs for harmonization with SEC requirements.

## **CTA Exclusion – Rule 4.6**

## **CTA Exemptions – Rule 4.14(a)(4) and (a)(5)**

Rule 4.6(a)(2) – excludes from the definition of CTA any person who is excluded from the definition of CPO under CFTC Rule 4.5

Rule 4.14(a)(4) – exempts from CTA registration any person registered as a CPO if the person's trading advice is directed solely to the pool for which it is registered as a CPO

Rule 4.14(a)(5) – exempts from CTA registration any person exempt from CPO registration if the person's trading advice is directed solely to the pool for which it is exempt from CPO registration

Note: Rule 4.14(c)(2) permits an adviser to be exempt for one pool under Rule 4.14(a) provisions but registered or excluded from registration with respect to other pools

## CTA Exemption – Rule 4.14(a)(8)

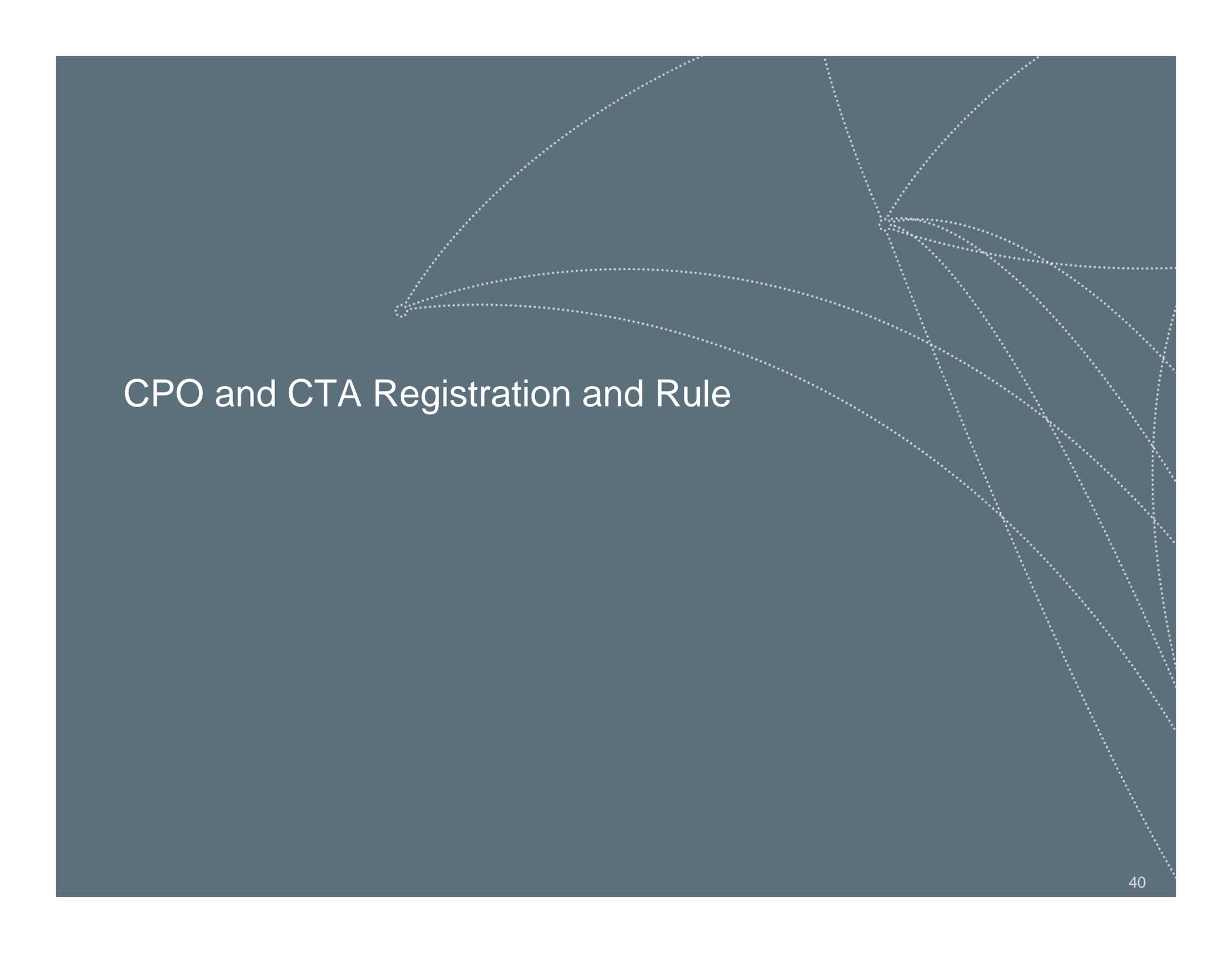
- Rule 4.14(a)(8) is a CTA exemption for:
  - registered as investment advisers under the Advisers Act
  - excluded from the definition of “investment adviser” pursuant to Sections 202(a)(2) (certain banks and trust companies) or 202(a)(11) of the Investment Advisers Act
  - U.S. state-registered investment advisers or
  - investment advisers that are exempt from federal and state registration
  
- To qualify for this exemption:
  - advice must be furnished only to certain entities:
    - Rule 4.5 entities
    - Rule 4.13(a)(3) pools
    - Pools that are organized and operated outside of the U.S. and have only non-U.S. person investors
  - advice must be “solely incidental” to investment adviser’s advisory business with respect to the entities listed above
  - the investment adviser must not otherwise hold itself out as a CTA
  
- Rule 4.14(a)(8) also contains certain notice filing requirements and requires the retention of certain records, and persons who rely upon the exemption are subject to special calls by CFTC staff

## CTA Exemptions – Section 4m(3) and 4m(1)

- CEA Section 4m(3): exemption from CTA definition for persons who are registered as investment advisers with the SEC under the Advisers Act whose business does not consist primarily of acting as CTAs, and who does not act as CTAs to any commodity pool that is engaged primarily in trading in any commodity interest
  - An adviser is “Engaged Primarily” if it holds itself out to the public as being engaged primarily in advising on commodity interests or investing, reinvesting, owning, holding or trading them
  - Issue: There is no guidance with respect to this provision other than statutory language
- CEA Section 4m(1): exemption from CTA registration for a person who provides commodity interest trading advice to 15 or fewer persons within the preceding 12 months and who does not hold itself out to the public as a CTA
  - Rule 4.14(a)(10) states that any entity that receives commodity interest trading advice based on its investment objectives, rather than on the individual investment objectives of its investors, would count as one “person” for purposes of Section 4m(1)
  - However, if a CTA holds itself out to the public as a CTA, this exemption does not apply, regardless of how many persons the CTA advises

## CTA Exemption – Rule 4.7(c)

- Rule 4.7(c) is the CTA analogue to Rule 4.7(b)'s CPO exemption
- Rule 4.7(c) is available to registered CTAs that provide commodity trading advice only to QEPs
- Provides significant disclosure and recordkeeping relief
- Notice requirements



# CPO and CTA Registration and Rule

## CPO and CTA Registration

- The CPO/CTA and its Associated Persons (“APs”) must register as such and “Principals” must be identified
- The CPO/CTA must also become a member of NFA and its APs must become associate members of NFA
- NFA handles registration processing on behalf of CFTC
- NFA requires members to maintain certain policies and procedures
- Applicants for registration as a CPO/CTA and membership in NFA must file Form 7-R and must submit a Form 8-R for each AP and each natural person “principal”

## Principals

- Who is a “principal”?
  - anyone with controlling influence, such as directors and officers
  - anyone with certain titles (regardless of ownership or controlling influence), including Director, President, CEO, COO, CFO for corporations, LLCs and LPs, general partner for LPs and manager and managing member for LLCs and LLPs
  - any natural person who owns 10% or more of the voting securities or contributed 10% or more of the capital
  - any entity that owns 10% of shares or contributed 10% or more of the capital

## Associated Persons

- Associated Person (“AP”) includes:
  - a natural person involved in soliciting funds, securities or property for participation in a commodity pool or opening a discretionary commodity interest trading account
  - as well as supervisors of such persons, even if those supervisors do not personally solicit
    - This includes every person in the line of supervisory authority over an AP and generally reaches up to the head of the firm
  - someone may be both a principal and an AP, and at least one principal must be an AP

## Principal and Associated Person Requirements

### Consequences of being a “Principal” and an “AP”

- registration with National Futures Association (“NFA”) on Form 8-R
- sponsor’s certificate
  - CPO or CTA must contact employers and educational institutions for past 3 years
- fingerprint card

### Additional requirements for APs:

- ethics training
- oversight requirements
- proficiency exam (usually Series 3)
  - exemptions and waivers of proficiency exam

## CPO/CTA Compliance Obligations

### Disclosure Document

- see Rules 4.21, 4.24, 4.25 and 4.26 for CPOs and Rules 4.31, 4.34, 4.35 and 4.36 for CTAs
- must be filed with the NFA, pre-cleared by the NFA and updated every 9 months
- must be distributed to each prospective pool participant/client
- past performance disclosure rules
  - if pool has less than a 3-year operating history, performance information must be supplied for other persons and entities (in addition to performance information for the offered pool), including the performance of other pools and managed accounts operated or traded by the CPO/CTA and the trading manager of the offered pool

## **CPO/CTA Compliance Obligations** *(cont'd)*

### Reporting to Both NFA and Investors

- CPOs must furnish to the NFA and to each pool participant certain prescribed reports

### Recordkeeping

- A CPO or CTA must keep, at its main business office, accurate books and records regarding each pool/client account it operates/advises
- records are subject to inspection by the CFTC, the NFA, and the U.S. Department of Justice

## NFA Requirements

- NFA By-Law 1101
  - “Self-policing” mechanism that requires that registered CPOs and CTAs only transact business with persons who are:
    - NFA members, or
    - exempt from registration
- Compliance Policies and Procedures
  - Including supervisory policies and ethics training
- Annual Self-Examination Checklist and Registration Update



# Registered Fund Harmonization Proposal

## Background on Harmonization Proposal

- Amendments to Rule 4.5 will require investment advisers to funds that do not satisfy the conditions in the amended rule for exclusion from CPO regulation to register as CPOs and comply with CFTC's CPO regulations, which generally are set forth in Part 4 of the CFTC's regulations
- The CFTC's CPO regulatory scheme contains additional, duplicative, inconsistent and conflicting disclosure, reporting and other requirements as compared to SEC regulations
- Harmonization proposal seeks to address certain matters and requests comment
- Comments on the proposal are due on April 24, 2012

## Areas of Harmonization – Disclosure Document

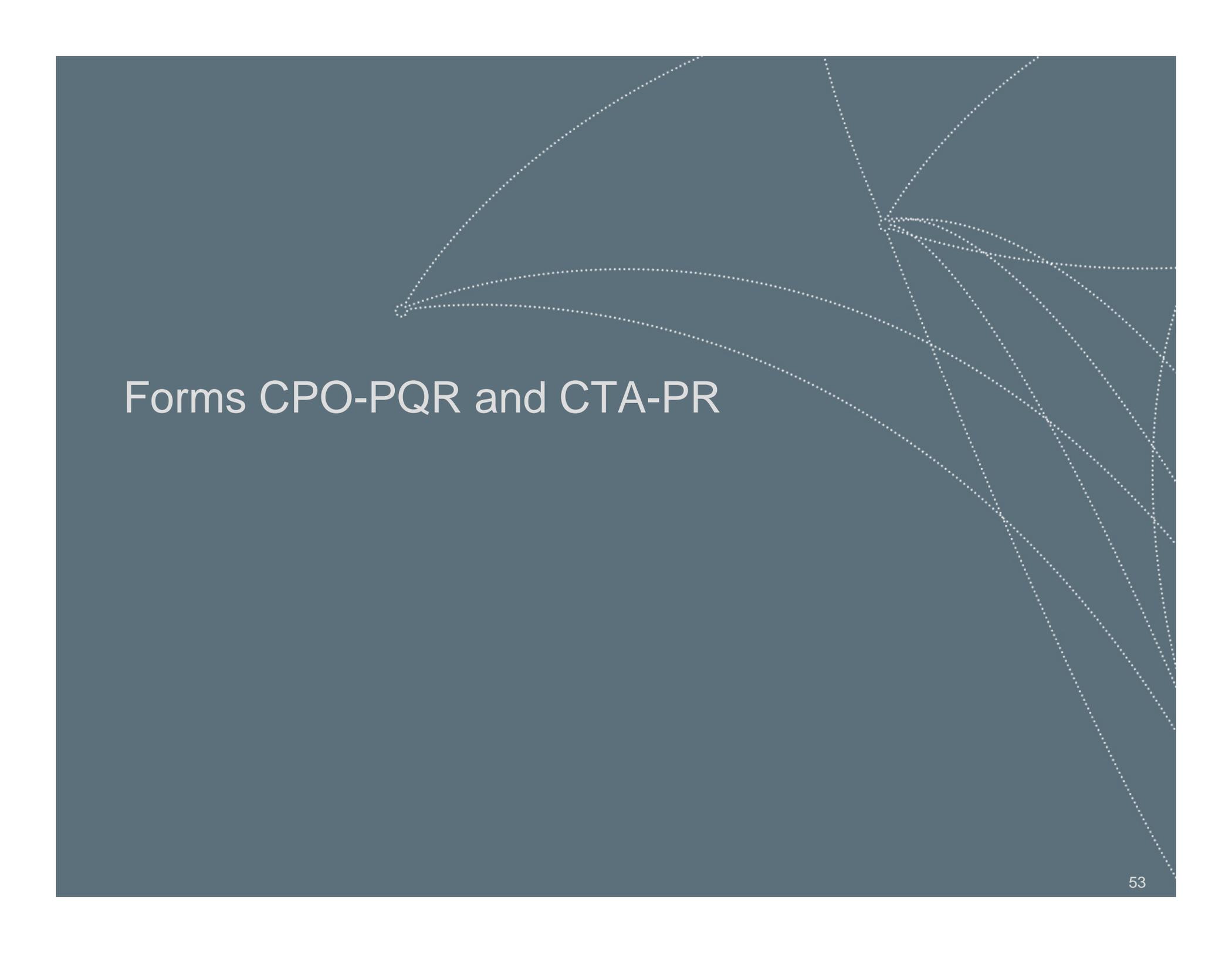
- Disclosure Document Delivery and Acknowledgement
  - Harmonization Proposal would exempt CPOs from the requirement to deliver a Disclosure Document no later than the time the CPO delivers a subscription agreement and from obtaining a signed acknowledgement regarding receipt of the Disclosure Document, provided that the CPO:
    - (1) posts the Disclosure Document on the CPO's web site,
    - (2) updates the Disclosure Document as required,
    - (3) informs prospective participants with whom it has contact of the web site address and directs intermediaries selling shares to so inform prospective participants, and
    - (4) the Disclosure Document otherwise complies with Part 4 requirements
- Disclosure Document Updating
  - Harmonization Proposal would permit CPOs to update Disclosure Documents every 12 months, rather than every 9 months

## Areas of Harmonization – Disclosure

- Performance Information
  - Harmonization Proposal recognizes that CFTC performance reporting requirements may conflict with the SEC’s requirements relating to the use of past performance and seeks comment on whether and how it should harmonize its performance reporting requirements
  - To the extent past performance disclosure is required, performance of other pools and accounts may be included in a Fund’s SAI
- Break-Even Point and Other Fee Disclosure
  - Harmonization Proposal does not provide any relief from the substantive fee disclosure requirements, but permits Funds to include these disclosures in the section of the prospectus following the summary section

## Areas of Harmonization – Reporting and Recordkeeping

- Periodic Reporting
  - Harmonization Proposal does not exempt CPOs from the monthly/quarterly account statement requirement, but permits CPOs to post account statements on a web site within 30 calendar days after the last day of the reporting period and continuing for a period of not less than 30 calendar days
- Recordkeeping
  - Harmonization Proposal provides an exemption from recordkeeping requirement to permit CPOs to maintain required books and records with the pool's administrator, distributor or custodian, rather than solely at the CPO's main business office, but does not permit use of other types of third parties such as professional record storage companies

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# Forms CPO-PQR and CTA-PR

## Forms CPO-PQR and CTA-PR

CFTC adopted CFTC Rule 4.27(d) that, jointly with the SEC, establishes new reporting requirements with respect to private funds

- requires CPOs and CTAs to report certain information to the CFTC on Forms CPO-PQR and CTA-PR, respectively
- CPOs dually registered with the SEC and CFTC that file Sections 1 and 2 of Form PF, as applicable, must generally file Schedule A of Form CPO-PQR only
- Non-dually registered CPOs must file all relevant sections of Form CPO-PQR based on certain reporting thresholds
- All CTAs, regardless of SEC registration, will complete Form CTA-PR

# CPO-PQR Schedules, Thresholds, and Deadlines

Assets Under Management	Schedule A	Schedule B	Schedule C
Dually registered (at least \$1.5 billion AUM)	Quarterly – 60 days (also filing Form PF)		
Dually registered (less than \$1.5 billion AUM)	Annually – 90 days (also filing Form PF)		
Large CPO (at least \$1.5 billion AUM)	Quarterly – 60 days (not filing Form PF)	Quarterly – 60 days (for each pool)	Quarterly – 60 days (for each “Large Pool”)
Mid-Sized CPO (at least \$150 million AUM)	Annually – 90 days (not filing Form PF)	Annually – 90 days (for each pool)	
Small CPO (less than \$150 million AUM)	Annually – 90 days (not filing Form PF)		

## CPO-PQR Schedules, Thresholds, and Deadlines *(cont'd)*

- Non-Form PF Pools. Even if a dually registered CPO files Form PF with the SEC, it may still need to file Schedules B and/or C if it has pools that were not captured on Form PF
- Fund-of-funds. Treatment of investments in other funds is consistent with the instructions adopted for Form PF
  - CPO may generally exclude any pool assets invested in other unaffiliated pools but must do so consistently for purposes of both thresholds and answering questions
  - CPO that operates a pool that invests substantially all of its assets in other pools for which it is not the CPO, and otherwise holds only cash and cash equivalents and instruments acquired to hedge currency exposure, must complete only Schedule A for that pool

## CPO-PQR Initial Filing Deadlines (12/31 fiscal year)

Commodity Pool Assets Under Management	Deadline
Large CPOs with at least \$5 billion AUM in commodity pools	November 29, 2012
Large CPOs with between \$1.5 billion and \$5 billion AUM in commodity pools	March 1, 2013
All other CPOs	March 31, 2013

- Rule 4.27 will become effective on July 2, 2012 and will apply to all registered CPOs regardless of whether they are still relying on Rule 4.13(a)(4) at that time

## Form CPO-PQR, Schedules A, B, C

Schedule A seeks basic identifying information about the CPO

Schedule B seeks information about each pool operated by a CPO

Schedule C seeks information from Large CPOs (at least \$1.5 billion gross AUM) on an aggregate basis as well as on an individual pool basis for each “Large Pool”

- “Large Pool” means any pool that has a net asset value individually, or in combination with any parallel pool structure, of at least \$500mm

## Form CTA-PR

- Requires all CTAs to provide basic information about the CTA's business and the pools for which it provides advice
- Form CTA-PR needs to be filed on an annual basis within 45 days after the end of the CTA's fiscal year
- Initial filing due on February 14, 2013 for most CTAs

# Panelists



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Ms. Gault-Brown is a partner in K&L Gates' Washington, D.C. office and a member of the Investment Management practice. She advises participants in the financial services industry, including commodity trading advisors, commodity pool operators, investment advisers, private funds, and registered investment companies on regulatory, transactional and counseling matters involving the securities and commodities laws. Ms. Gault-Brown regularly works with commodity trading advisors and commodity pool operators with respect to registration, disclosure, and compliance issues. Ms. Gault-Brown also regularly counsels registered investment companies about issues raised by investments in derivatives under the Investment Company Act. Ms. Gault-Brown joined the firm after three years at the Securities and Exchange Commission where she was a senior counsel in the Division of Investment Management's Office of Chief Counsel. At the SEC, among other matters, Ms. Gault-Brown focused on the regulatory treatment under the federal securities laws and commodities laws of registered funds and registered advisers that used OTC derivatives.



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Stuart Fross is a partner in K&L Gates' Boston office where he concentrates his practice on securities laws and regulations, as part of the Investment Management Practice Group. Mr. Fross' main focus is investment managers and pooled investment vehicles, including US registered open-end, closed end and exchange traded funds, bank collective investment funds (with an emphasis a stable value funds), UCITS funds, as well as private funds, organized in the US and offshore. Mr. Fross has extensive experience in equity, high-income and fixed income trading operations, as well as with distribution related issues for registered and unregistered funds.



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